IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 238 of 1995

For Approval and Signature:

HONOURABLE MR.JUSTICE R.S.GARG

HONOURABLE MR.JUSTICE M.R. SHAH

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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SYNBIOTICS LIMITED - Applicant(s)
Versus
COMMISSIONER OF INCOME TAX - Respondent(s)

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Appearance :
MR RK PATEL for Applicant(s) : 1,
MR MANISH R BHATT for Respondent(s) : 1,

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CORAM : HONOURABLE MR.JUSTICE R.S.GARG
and
HONOURABLE MR.JUSTICE M.R. SHAH

Date : 23/08/2006

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE R.S.GARG)

At the instance of the assessee, M/s Synbiotics Limited, Ahmedabad, the Income Tax Appellate Tribunal, Ahmedabad, Bench “C” has made this Reference in relation to Income tax Appeal No.1452/Ahd/1985 relating to assessment year, 1981-82, the following questions for opinion of this Court;

1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the amount of Rs.28,646/- paid as guarantee commission was on capital account and disallowable as such?
2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that an amount of Rs.6976/- in respect of exchange loss was disallowable as capital expenditure?
3. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the claim of assessee for Rs.1,34,05,048/- was not allowable?

2. The short facts necessary for disposal of the present Reference are that the assessee is a limited

company carrying on business of manufacturing and selling chemicals and pharmaceuticals. The assessee, in the course of its business, manufactures antibiotics namely Streptomycin and Tetracycline on bulk basis, which accounts for more than 90% of the production. In the year under consideration (assessment year 1981-82), the antibiotic production was 1,75,038 kgs. During assessment proceedings, the assessee claimed by way of deduction a sum of Rs.1,34,65,048.00 being demand of Government under Drug Price Control Order for payment to Drug Price Equalisation Account (hereinafter referred to DPCO and DPEA for short) on the ground that Streptomycin being manufactured by the assessee in bulk is covered under DPCO and paragraph 7 of DPCO provides that Government may fix the pooled price for a bulk drug covered by it and a retention price for individual manufacture of the said bulk drug. Paragraph 17 of the DPCO provides that manufacturer shall pay into the DPEA the difference between the pooled price and the retention price on the quantity of the bulk drug manufactured and sold by him. The assessee asserted before the Assessing Officer that Government of India vide its letter dated 10-6-1980 called upon the assessee to pay into DPEA such difference and the total demand raised by the Government upto 31-3-

1981 at Rs.1,34,05,048.00, they were entitled to deduction of the said amount from their income. The Assessing Officer observed that the assessee had charged only the retention price from Sarabhai Chemicals, a sister concern to whom the Streptomycin was sold and the liability could not be quantified in the absence of difference between selling price and the retention price. It was also observed that the assessee company had contested the demand made by the Government by throwing a challenge in form of a writ application before the High Court of Delhi in January, 1981. The Assessing Officer observed that the said demand had not been entered into the books of account, therefore, the claim of the assessee could not be granted. Being dissatisfied with the said assessment order, the assessee appealed before the CIT (Appeals), the same grounds were raised and it was submitted that liability to pay the aforesaid demand of Rs.1,34,05,048.00 was for the period ending on 31-3-1981 and, as the same was admissible, even though, disputed by the assessee and unpaid but in view of the judgment of the Supreme Court in the matter of Kedarnath Jute Manufacturing Co. V. CIT (Central) Calcutta 1971(82) ITR 363, the assessee was entitled for such deduction. The learned CIT (Appeals) did not concede to the

submission and proposed to distinguish the judgment of the Hon'ble Supreme Court. The matter was taken up in further appeal on the same grounds. After considering the facts and rival submissions, the Tribunal opined that as the assessee had filed the writ before the Hon'ble High Court of Delhi challenging the very demand of Rs.1,34,05,048.00 and obtained the stay against the demand, then the said amount could not be treated as a liability. The Tribunal also distinguished the above referred judgment of the Supreme Court and dismissed the appeal. The assessee being aggrieved by the said judgment of the Tribunal, made an application under Section 256(1) of the Income Tax Act, 1961 on certain proposed questions. The Tribunal after hearing the parties in Reference Application Nos.625/Ahd/1987 and 1677/Ahd/1994, referred the question Nos.1 and 2, as proposed by the assessee and also referred the third question after redrafting the same.

3. So far as the first question is concerned, we must immediately observe that an identical question has been answered by Apex Court in 227 ITR 464, Additional Commissioner of Income Tax V. Akkamamba Textiles Ltd and 227 ITR 465, Commissioner of Income Tax V. Sivakami Mills

Ltd. In both of the said judgments, the Supreme Court has observed that the guarantee commission paid to the banker and the insurance company for ensuring deferred payment of purchase consideration of machinery would constitute revenue expenditure. In light of the said two authoritative pronouncement of the Supreme Court, the question No.1 is necessarily to be answered in favour of the assessee.

4. So far as question No.2 is concerned, learned counsel for the assessee submits that looking to the smallness of the amount, the assessee does not propose to press the said question. In view of the said submission, question No.2 is not answered.

5. So far as question No.3 is concerned, it is brought on record that the writ application filed by the present assessee before the Hon'ble High Court of Delhi has been finally disposed of by the said High Court on 4-10-2002 and the High Court has quashed the said demand made under DPCO. Learned counsel for the assessee further submits that the matter was not allowed to be at rest at that stage, and the State/Union have chosen to prefer appeals before the Division Bench and have ultimately filed

Transfer Application No.91 of 2006 before the Apex Court for transfer of all such cases to the Supreme Court for simultaneous hearing. He submits that as the appeal has already been filed, at this stage, it must be observed that the demand subsists. On being asked that whether any stay on the judgment of the Delhi High Court has been granted by any Court, the learned counsel submitted that he was not aware of that.

6. Learned counsel for the assessee further submits that though the demand has been quashed, but as the appeals have been preferred and the matters are sub-judice and nobody knows that what would be the end result of the litigation, the Reference must be decided in favour of the assessee. When the matter was taken up for hearing on the last date, we informed the learned counsel for the assessee that if the demand has already been quashed, then the judgment of the Supreme Court in the matter of Kedarnath Jute Manufacturing Co. (supra) would have no application and in case it is held that the income tax cannot be counted for the assessment year in dispute, then the income will have to be aggregated with the income of the year in which the Delhi High Court decided the matter. We have put a query to the learned

counsel for the assessee that in either of the case, the assessee would be obliged to pay the tax. Mr. R.K. Patel, learned counsel for the assessee prayed for a short adjournment to seek further instruction in the matter. We accordingly listed the case today for further hearing. Mr. Patel at the first opportunity, informs the Court that the assessee is not agreeable to either of the proposal made by the Court and the Court may decide the matter in accordance with law.

7. In the matter of Kedarnath Jute Manufacturing Co. (supra), the assessee company, which followed the mercantile system of accounting, incurred a liability of Rs.1,49,776.00 on account of sales tax determined to be payable by the sales tax authorities on the sales made by the assessee during the calendar year 1954, the previous year relevant to the assessment year 1955-56. The sales tax demands were raised pending the income tax assessment for that year. The Income tax Officer rejected the assessee's claim for deduction of that amount on the ground (1) that the assessee had contested the sales tax liability in appeals and (ii) that it had made no provision in its books with regard to the payment of that amount. The Supreme Court observed that the moment a

dealer made either purchases or sales which were subject to sales tax, the obligation to pay the tax arose. Although that liability could not be enforced till quantification was effected by assessment proceedings, the liability for payment of tax was independent of the assessment. The Supreme Court also observed that whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights; nor can the existence or absence of entries in his books of account would be decisive or conclusive in the matter.

8. After going through the entire judgment in the above metter, we must observe that the approach of the CIT (Appeals) and that of the Tribunal was contrary to law. The Supreme Court was candid in observing that existence or absence of entries in the books of account would not be decisive or conclusive in the matter. The fine distinction sought to be carved out by the CIT (Appeals) and the Income Tax Tribunal that the said judgment in the matter of Kedarnath Jute Manufacturing Co. would not be applicable, runs contrary to the very judgment of the Supreme Court. The Supreme Court has observed that in a

given case, the liability may not be enforced till quantification was effected by assessment proceedings, but the liability for payment of tax would be independent of the assessment. In the said matter, the Supreme Court observed that the deduction ought to have been allowed in favour of the assessee.

9. Following the judgment in the matter of Kedarnath Jute Manufacturing Co. (supra), we could certainly decide the Reference in favour of the assessee but the subsequent events, which have come into existence, have put different colour in the entire factual scenario. Undisputedly, the writ application filed by the present assessee has been allowed by Delhi High Court. Once the writ application is allowed and the demand is quashed, then the assessee would not be entitled to say that he is still facing the sword of the demand and as such he would be entitled to deduction. Undisputedly, if the challenge to the demand fails and the assessee is held liable to pay under the demand made by the Union Government, then he would be entitled to deduction, but in case the demand is quashed and the assessee does not face any danger of paying the amount, then the said amount claimed under the demand cannot be deducted. The question that the appeals

have been filed challenging the order passed by the learned Single Judge of Delhi High Court and transfer applications are also filed before the Supreme Court, would not nullify the effect of the judgment of the learned Single Judge under which the demands were quashed. Undisputedly, as on today, no demand is in existence and if the demand is not in existence, then the judgment of the Supreme Court in the matter of Kedarnath Jute Manufacturing Co.(supra) would not provide any protective umbrella to the present assessee. That judgment is not an authority on the question that despite quashing of the demand and pendency of an appeal at the instance of the revenue, the deduction is still to be granted in favour of the assessee. If the submission of learned counsel for the assessee is accepted, then on one side, he would be entitled to deduction for the assessment year 1981-82 and at the same time, he would not be answerable to pay any tax even in the year, in which the demand has been quashed, he would be entitled to retain the entire amount of Rs.1,34,05,048.00 and would also be not paying tax on it either in the assessment year 1981-82 or in the accounting year 1-4-2002 ending on 31-3-2003. The judgment of the Supreme Court is to be applied to the given set of facts and not

in its abstract form, because the Supreme Court decides a case on particular facts of the case. The stray observation made by the Supreme Court if, are read out of the context, they may lead to chaotic results. The application of the judgment of the Supreme Court in the matter of Kedarnath Jute Manufacturing Co. in the changed scenario, would certainly lead to a chaotic situation. Taking into consideration the totality of the circumstances and that subsequent events have superimposed, in the meanwhile, it must be held that the judgment in the matter of Kedarnath Jute Manufacturing Co. (supra) would not be applicable to the present case and, as the assessee is not required to make the deposit with the Union of India according to the demand under DPCO, he would not be entitled to any deduction.

10. The orders passed by the CIT (Appeals) and the Tax Tribunal on the reasonings given by them, cannot be upheld but we must hold that the assessee in the changed circumstances, is not entitled to any relief. The Reference stands disposed of. No costs.

(R.S.GARG, J.)

shekhar/- (M.R.SHAH,J.)